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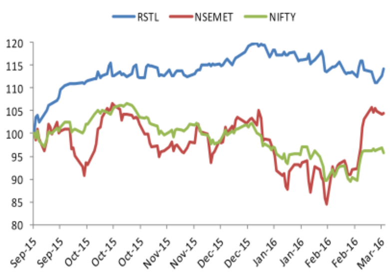
Rama Steel Tubes Limited

15 March 2016

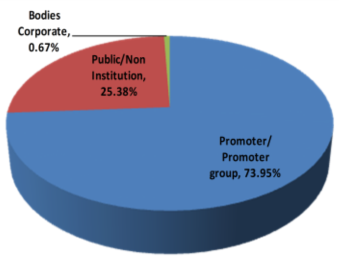
Plant Visit Note

Sector	: Steel Tubes/Pipes
Target Price	: Rs 135
Current Market Price	: Rs 90
Market Cap	: Rs 1348.5 mn
52-week High/Low	: Rs 95/75
Daily Avg. Volume	: 130,268
Shares in issue	: 14.9 mn
Face Value	: Rs 5
Beta	: 0.52
Pledged Shares	: 0%
Year End	: 31st March
BSE Scrip Code	: 539309
NSE Scrip Code	: RAMASTEEL
Bloomberg Code	: RASTL IN
Reuters Code	: RAMA.NS
Nifty	: 7,461
Sensex	: 24,551
Analyst	: Raj Kumar Jha Ankit Merchant Ronak Jhaveri

Price Performance



Shareholding Pattern



Visit Note Updates

We recently met the management and the senior-most person from Rama Steel Tubes limited (RSTL), who is in charge of production at the Khopoli plant, Maharashtra, to understand the business and the growth potential in the present market scenario.

Four decades of experience, availability of land and newer plants seem to make a great combo

With experience of more than four decades in the steel-component sector, RSTL has diversified business segments, catering to domestic and export markets. It has more than 20 acres at Khopoli, Maharashtra, of which 14 acre is owned, the rest on lease for 99 years. The company transforms basic steel to tubes, galvanized products, structural products, etc. These are value-added products for infrastructure projects, commanding high margins.

Increased production and cost control to expand margins

At present, RSTL has three manufacturing plants: two at Sahibabad (Uttar Pradesh), of 75,000 tonnes per annum (tpa) and 24,000 tpa, and one at Khopoli (Maharashtra) of 36,000 tpa. The plant at Khopoli commenced commercial production in June 2015, and is now running at almost full capacity, though it can run higher aided by advanced technology.

A second plant (of 36,000 tpa) is currently being set up and management says commercial production would start by May 2016. Further, in the next two years, it plans to enhance capacity to 240,000 tpa at Khapoli, leveraging the benefit of the 20 acres and robust demand. The existing and the new plant are spread over three acres. Further, the company plans to build an additional five similar plants (totaling seven) on the spare land. Land leveling for this is expected to be completed by Q1 FY 2017.

Demand uptick and focus on export to boost topline

Rama Steel Tube currently caters to rising demand from Maharashtra. However, it aims to eventually route most exports through its Khopoli plant due to the latter's proximity to the Jawaharlal Nehru Port.

Management estimates that Maharashtra has a deficit (for pipes) of around 12,000 tonnes per month due to lower production in the state. Currently, this demand is met by other states. We believe that, with the capacity expansion, the company would be in a position to capture a greater share of the demand pie. At present, it receives healthy orders from the Pune region and a plant in Khopoli seems reasonable, saving on transportation costs.

At the Sahibabad plant, the company produces black pipes and galvanized iron pipes. At the Khopoli plant, however, only black pipes are produced and the company is in the process of commencing production of galvanized iron

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pipes. Management says that, once GI pipe production starts, exports from Khopoli will begin, further raising revenue and margins.

Capacity expansion to help company capture a greater share of the demand pie

Promising product pipeline and customized products to drive margins

Rama Steel Tubes is primarily into production of black pipes from flattened steel; it also produces galvanized iron pipes. Its black pipes come in various thicknesses and sizes, depending upon customer requirements. High Thickness Black Pipes are primarily used by the automobile industry, whereas Low Thickness Black Pipes are used in construction. Although the company receives healthy orders for High Thickness Black Pipes, better margins are to be found in Low Thickness Black Pipes. We believe that, as demand for more fuel-efficient cars and light-weight vehicles increases, the company's Low Thickness Black Pipes would see a pick-up in demand, resulting in better margins.

Per unit figures unleash the potential

The company imports its raw materials or procures them from domestic suppliers. Recently, the gap between indigenous and imported raw materials has shrunk significantly; hence, the company prefers to use indigenous raw material. It generally imports its requirements from China, Ukraine and Korea. Its landed cost of raw steel is between Rs. 26,000 and Rs.27,000 a tonne (imported/domestic). Further, its conversion cost of Black Pipes is. Rs.4,000 to Rs.5,000 a tonne. Hence, the average cost per tonne is around Rs.32,000 (including plant maintenance). On the other hand, the average selling price of basic Black Pipes is Rs.36,000 to Rs.37,000, net of excise, which works out to more than a 12% margin per tonne. However, we believe that, as Rama Steel Tubes achieves economies of scale and with further value additions, the margins for Black Pipes per tonne could expand to ~15-17%.

Black Pipes - more than a 12% margin

Similarly, GI pipes, which are galvanized black pipes' conversion cost, is Rs.1,600 to 2,000 a tonne higher than for Black Pipes, resulting in an average cost per tonne of Rs.34,000. However as GI pipes have fewer producers, Rama Steel Tubes being one of them, they come at an average Rs. 52,000 a tonne, resulting in higher margins.

Outlook

We maintain our Strong Buy on RSTL with a target price of Rs 135, a ~49% upside.

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Guide to Khambatta's research approach

Valuation methodologies

We apply the following absolute/relative valuation methodologies to derive the 'fair value' of the stock as a part of our fundamental research:

DCF: The Discounted Cash Flow (DCF) method values an estimated stream of future free cash flows discounted to the present day, using a company's WACC or cost of equity. This method is used to estimate the attractiveness of an investment opportunity and as such provides a good measure of the company's value in absolute terms. There are several approaches to discounted cash flow analysis, including Free Cash Flow to Firm (FCFF), Free Cash Flow to Equity (FCFE) and the Dividend Discount Model (DDM). The selection of a particular approach depends on the particular company being researched and valued.

ERE: The Excess Return to Equity (ERE) method takes into consideration the absolute value of a company's return to equity in excess of its cost of equity discounted to the present day using the cost of equity. This methodology is more appropriate for valuing banking stocks than FCFF or FCFE methodologies.

Relative valuation: In relative valuation, various comparative multiples or ratios including Price/Earnings, Price/Sales, EV/Sales, EV/EBITDA, Price/Book Value are used to assess the relative worth of companies which operate in the same industry/industries and are thereby in the same peer group. Generally our approach involves the use of two multiples to estimate the relative valuation of a stock.

Other methodologies such as DuPont Analysis, CFROI, NAV and Sum-of-the-Parts (SOTP) are applied where appropriate.

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Strong Buy recommendations are expected to improve, based on consideration of the fundamental view and the currency impact (where applicable) by at least 15%.

Market-perform recommendations are expected to improve, based on consideration of the fundamental view and the currency impact (where applicable) between 5% and 15%.

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